

# Table of Contents

<b>Executive Summary</b>	<a href="#">Click Here To View</a>	<b>i</b>
<b>Introduction</b>		<b>1</b>
Background		1
Audit Scope, Objectives, And Methodology		3
Major Accomplishments Related To This Program		4
<b>Finding I</b>		
<b>The Building Division Needs To Implement Additional Controls To Ensure That It Applies And Charges Building Permit Fees Consistently And Correctly</b>		<b>5</b>
The Municipal Code Defines Valuation		6
The Building Division Assesses Building-Related Permit Fees		8
Insufficient Documentation Prevents Verification Of Proper Valuation On Many Building Permit Applications		11
The Division Staff Did Not Consistently Apply Building Permit Fees		14
The Division Inconsistently Issued Partial Permits		17
The Division Did Not Retroactively Assess Applicable Development Taxes For Shell Only Structures		18
Lack Of Policies And Procedures		20
The Building Division Does Not Have A Formal Quality Assurance Process		21
The Building Division May Have Failed To Assess \$49,400 In Building Related Fees		22
CONCLUSION		22
RECOMMENDATIONS		22
<b>Finding II</b>		
<b>Improvements Are Needed To Ensure That The Building Division Assesses And Collects Development Taxes Consistently And In Compliance With Municipal Code Requirements</b>		<b>25</b>
The Building Division Collects Municipal Code-Specified Taxes		25
The City Offers Builders Exemptions From Development Taxes Based On Building Location And Structure Use		27
The Municipal Code Defines Industrial And Commercial Uses		28
The Division Uses A Matrix To Define Industrial/ Commercial Uses		29
Fee Revenue Collected		29

The Division Charged Applicants For Development Taxes Even Though  
The Permitted Properties Were Exempt From Taxes .....30

Staff Sometimes Have To Rely On Maps To Determine A Property’s  
Location .....31

The Division Misapplied Commercial, Residential, And Mobile Home  
Parks Tax (CRMP).....31

The Building Division Has No Formal Policies And Procedures On  
Assessing The CRMP Tax .....32

Improvements Are Needed To Ensure Buildings Are Classified In  
Compliance With Municipal Code Requirements .....33

The Division Needs To Ensure That Staff Are In Agreement On How To  
Classify Multiple Use Structures .....34

Several Factors Hamper The Ability Of The Division Staff To Ensure  
That Structures Are Properly Designated .....35

Building Permit Applications Do Not Provide Detailed Information To  
Make Informed Decisions.....35

Additional Follow-Up Efforts Can Ensure Building Use Is Accurate.....37

Development Tax Matrix Used To Define Industrial Structures Needs To  
Be Improved.....37

Responsibility Not Assigned For Determining Building Use In Unclear  
Situations .....37

Inaccurate Structure Designations Can Lead To Significant Underpayment  
Of Taxes.....38

CONCLUSION .....38

RECOMMENDATIONS .....39

**Administration's Response** [Click Here To View](#) .....41

**Appendix A**

[Click Here To View](#)

**Definitions Of Priority 1, 2, And 3 Audit Recommendations** ..... A-1

**Appendix B**

[Click Here To View](#)

**Policy On Determination Of Valuation Of Remodeling/Alteration Projects  
(Revised 7/1/00)** .....B-1

**Appendix C**

[Click Here To View](#)

**Policy On Determination Of Valuation Of Remodeling/Alteration Projects  
(Revised 7/19/00)** ..... C-1

**Appendix D**

[Click Here To View](#)

**Memorandum Of Program Accomplishments**..... D-1

# Table of Exhibits

## **Exhibit 1**

Summary Of Building Permit Revenues 1989-90 Through 1999-00 .....	2
---	---

## **Exhibit 2**

Commercial/Industrial Building Permit Valuations Per Square Foot For the Period July 1, 2000 To June 30, 2001 .....	7
--	---

## **Exhibit 3**

Building Permit Fee Table, 2000-01 .....	8
--	---

## **Exhibit 4**

Plumbing, Mechanical, Electrical Permit Fees For Residential And Non- Residential New Construction, Additions and Alterations .....	9
--	---

## **Exhibit 5**

Summary Of Development Tax Rates .....	26
--	----

## **Exhibit 6**

Summary Of The Tax Exemption Zones, Taxes Suspended, Eligible Development, And Duration .....	27
--	----

## **Exhibit 7**

Development Tax Revenue Collected In 1998-99 And 1999-00.....	30
---	----

## **Exhibit 8**

Project With Multiple Commercial And Industrial Designations.....	33
---	----

# Introduction

In accordance with the City Auditor’s 1999-2000 Audit Workplan, we have audited the Building Division (Division) building permit fee process. The Division is part of the Department of Planning, Building, and Code Enforcement (Department). This audit is the second in a series of audit reports on the Division. We conducted this audit in accordance with generally accepted government auditing standards and limited our work to those areas specified in the Scope and Methodology section of this report.

The City Auditor’s Office thanks the Department, and Division staff, who gave their time, information, insight, and cooperation during the audit process.

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## Background

The Division’s mission is to protect the lives and safety of the citizens of San Jose and contribute to the City's economic development. This is accomplished through implementation and enforcement of the Building, Plumbing, Mechanical, and Electrical Codes (Codes). The Division also implements Engineering, Energy, and Disabled Access regulations, and local and state laws for new construction.

The Division’s role in the development process begins by reviewing all construction plans for all new residential, commercial, and industrial buildings and alterations to those buildings. Plan Check Engineers review the plans to verify that the proposed construction project is designed to meet the minimum safety requirements specified in the Codes. When the Division determines that the building plans comply with applicable Codes, the Division issues building permits authorizing construction. During a structure’s construction phase, Division inspectors will perform on-site inspections to verify compliance with the approved building plans, and applicable local and state regulations. After a final inspection, the Division is supposed to issue certificates of occupancy for each new building or when a change of use occurs. This certifies that the building is ready to be occupied for its stipulated use.

A building permit is required for any building, structure, or building service equipment that is regulated by the Uniform Building Code (UBC), Uniform Plumbing Code (UPC), Uniform Mechanical Code (UMC), or the National Electrical

Code (NEC). A separate permit is required to erect, construct, enlarge, alter, repair, move, improve, convert or demolish a building, structure, or any building service equipment.

*Budget And Staffing*

In 2000-01, the Division’s budget is \$13.3 million, which includes \$12 million in personal services and \$1.2 million in non-personal services (including equipment). Building-related permit fees fund almost all of the Division’s operating costs.

The Chief Building Official heads the Division, which is organized into three main sections: Permit Center, Plan Check Section, and Inspection Section. In 2000-01, the Division is authorized 144 full-time equivalent positions.

*Building Permit And Plan Check Revenue Collected*

In 1999-00, the Division collected \$19 million in revenue from Plan Check, Permit (Building, Plumbing, Electrical, and Mechanical), Record Retention, and miscellaneous fees assessed for residential, commercial, and industrial projects. This was an 11.4 percent or \$1.9 million increase from the previous fiscal year.

*Total Building Revenue Increased Significantly*

In the mid-1990’s, total Division plan check and building permit revenue increased significantly. Exhibit 1 summarizes total building-related permit revenues from 1989-90 through 1999-00.

**Exhibit 1      Summary Of Building Permit Revenues  
1989-90 Through 1999-00**

Fiscal Year	Building Permit Revenue	Increase (Decrease)	Percent Increase (Decrease)
1989-90	\$5,600,640	--	--
1990-91	\$6,119,422	\$518,782	9.3%
1991-92	\$6,298,068	\$178,646	2.9%
1992-93	\$6,012,056	(\$286,012)	(4.5%)
1993-94	\$7,691,967	\$1,679,911	27.9%
1994-95	\$7,520,668	(\$171,299)	(2.2%)
1995-96	\$11,861,230	\$4,340,562	57.7%
1996-97	\$15,537,533	\$3,676,303	31.0%
1997-98	\$19,532,517	\$3,994,984	25.7%
1998-99 <sup>1</sup>	\$16,962,931	(\$2,569,586)	(13.2%)
1999-00	\$18,893,882	\$1,930,951	11.4%

<sup>1</sup> A contributing factor to the decline was a reduction in certain building-related permit fees and a reduction in new construction residential permits.

Source: Auditor analysis of Building Division data.

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**Audit Scope,  
Objectives, And  
Methodology**

We examined data on building permits the Division processed between January 4<sup>th</sup>, 1999 and June 30<sup>th</sup>, 1999. During this period the Division processed a total of 6,196 permits for construction activity valued at about \$563 million.

The Division uses 20 project types to categorize building permits into two main categories - new construction and alteration. We further defined these categories by building type – residential, multi-family, commercial, and industrial. We excluded demolition and re-roof permits.

As a result we determined that there were 3,300 building permits that met our classification criteria with a total valuation of about \$546 million. We then sorted each stratification by date and randomly selected permit numbers from each strata. Our total sample size by this method was 128 permit applications.

***Sample Size***

We included in our sample size 20 randomly selected permit applications for residential alterations and additions valued at over \$100,000. We reviewed a total of 148 permit applications.

In addition, we also reviewed all refund applications processed between February 1999 and January 2000 for more than \$1,000. The Division issued about 360 refunds in the period between February 1999 and January 2000 with a total value of about \$1 million. Of these we reviewed twenty refunds for over \$1,000 with a total value of about \$121,000. We reviewed these refunds for reasons for refunds. We did not review for cash propriety or refund practices.

We reviewed each permit application to determine if the Division,

- Valued the properties according to appropriate City of San Jose Codes and Ordinances;
- Valued the properties in a consistent manner;
- Handled alterations for residential and commercial structures consistently; and
- Applied development taxes appropriately and consistently.

<b>Major Accomplishments Related To This Program</b>	In Appendix D, the Building Division informs us of its major accomplishments.
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## Finding I

# **The Building Division Needs To Implement Additional Controls To Ensure That It Applies And Charges Building Permit Fees Consistently And Correctly**

The San Jose Municipal Code prescribes how various building-related fees and charges are to be calculated and assessed to applicants. The Building Division (Division) is responsible for assessing and collecting these various fees and charges in compliance with the Municipal Code. We found several problems with the Division's handling of various building-related permit fees and associated charges. Specifically, for the cases we sampled, we found that the Division

- Did not document that they verified self-reported valuations for commercial and industrial construction;
- Did not use minimum valuations for the sampled residential alteration permits 40 percent of the time;
- Did not adequately document how plan check fees were calculated 14 percent of the time;
- Did not assess supplemental plan check fees in all applicable situations;
- Inconsistently calculated or issued sub-trade permits 7 percent of the time;
- Inconsistently issued partial permits; and
- Did not retroactively assess development taxes for shell only structures.

As a result, the Division did not consistently adhere to Municipal Code requirements or treat all applicants the same, and did not charge applicants an estimated \$49,000. In our opinion, the Division needs to develop formal policies and procedures regarding 1) verifying valuations for new commercial and industrial construction; 2) using minimum valuations; 3) calculating plan check fees; 4) assessing supplemental plan check fees; 5) calculating sub-trade permits; 6) issuing partial permits; and 7) retroactively assessing development taxes for shell only structures.

In addition, the Division should develop and implement a formal quality assurance process to ensure that Division staff apply building permit fees and charges consistently and correctly.

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**The Municipal Code Defines Valuation**

The Uniform Building Code (UBC) provides that the local building official is responsible for determining a project’s valuation. The Division uses the valuation to compute building permit fees and development taxes, and indirectly plan review fees. The Municipal Code (24:01.290) establishes that building valuation shall be the estimated cost to replace the building and its service equipment based on current replacement costs. The Municipal Code also specifies that in no case shall the valuation be less than the published valuation rates contained in the latest edition of the International Conference of Building Officials’ (ICBO) Building Standards magazine. Additionally, the Division uses a regional modifier of 1.13 along with the valuation data for non-residential construction. Division staff are supposed to verify the valuation amounts by comparing the valuation amount against the published valuation rate or by reviewing a builder’s bid documents. Exhibit 2 shows valuation rates per square foot for commercial and industrial buildings effective July 1, 2000 to June 30, 2001.

**Exhibit 2      Commercial/Industrial Building Permit Valuations  
Per Square Foot For the Period July 1, 2000  
To June 30, 2001**

Occupancy and Type	Cost per Square Foot, Average	Occupancy and Type	Cost per Square Foot, Average	Occupancy and Type	Cost per Square Foot, Average	Occupancy and Type	Cost per Square Foot, Average
<b>1. APARTMENT HOUSES:</b>		<b>7. DWELLINGS:</b>		<b>8. FIRE STATIONS:</b>		<b>20. RESTAURANTS:</b>	
Type I or II F.R.* .....	\$82.20	Refer to Residential Building Permit Valuation Table		Type I or II F.R. ....	\$147.10	Type III-1-Hour ....	\$90.20
(Good) \$101.00 .....				Type III-1-Hour ....	134.40	Type III-N .....	87.10
Type V-Masonry .....	67.20			Type V-1-Hour ....	100.90	Type V-1-Hour ....	82.50
(or Type III) (Good) \$82.10 .....				<b>14. LIBRARIES:</b>		Type V-N .....	79.40
Type V-Wood Frame. (Good) \$75.90 .....	59.00			Type I or II F.R. ....	107.70	<b>21. SCHOOLS:</b>	
Type I-Hourant Gauge .....	34.70			Type II-1-Hour ....	78.80	Type I or II F.R. ....	102.90
<b>2. AUDITORIUMS:</b>		<b>8. FIRE STATIONS:</b>		Type II-N .....	74.90	Type II-1-Hour ....	70.20
Type I or II F.R. ....	97.00	Type I or II F.R. ....	105.90	Type III-1-Hour ....	83.20	Type III-1-Hour ....	75.10
Type II-1-Hour .....	70.20	Type II-1-Hour .....	69.60	Type III-N .....	79.00	Type III-N .....	72.30
Type II-N .....	66.50	Type II-N .....	65.70	Type V-1-Hour ....	78.20	Type V-1-Hour ....	70.40
Type III-1-Hour .....	73.80	Type III-1-Hour ....	76.30	Type V-N .....	74.90	Type V-N .....	67.20
Type III-N .....	70.00	Type III-N .....	73.00	<b>15. MEDICAL OFFICES:</b>		<b>22. SERVICE STATIONS:</b>	
Type V-1-Hour ....	70.60	Type V-1-Hour ....	71.40	Type I or II F.R. ....	110.50	Type II-N .....	62.20
Type V-N .....	45.90	Type V-N .....	67.90	Type II-1-Hour ....	85.30	Type III-1-Hour ....	64.80
<b>3. BANKS:</b>		<b>9. HOMES FOR THE ELDERLY:</b>		Type II-N .....	81.00	Type V-1-Hour ....	55.20
Type I or II F.R.* ....	136.90	Type I or II F.R. ....	96.00	Type III-1-Hour ....	89.80	Canopies .....	25.90
Type II-1-Hour .....	100.90	Type II-1-Hour ....	78.00	Type III-N .....	86.20	<b>23. STORES:</b>	
Type II-N .....	97.70	Type II-N .....	74.60	Type V-1-Hour ....	83.40	Type I or II F.R.* ....	76.30
Type III-1-Hour .....	111.40	Type III-1-Hour ....	81.10	Type V-N .....	80.50	Type II-1-Hour ....	46.70
Type III-N .....	107.40	Type III-N .....	77.90	<b>14. OFFICES**:</b>		Type II-N .....	45.50
Type V-1-Hour ....	100.90	Type V-1-Hour ....	78.50	Type I or II F.R.* ....	98.70	Type III-1-Hour ....	56.70
Type V-N .....	96.70	Type V-N .....	75.70	Type II-1-Hour ....	66.20	Type III-N .....	53.20
<b>4. BOWLING ALLEYS:</b>		<b>10. HOSPITALS</b>		Type II-N .....	63.00	Type V-1-Hour ....	47.80
Type II-1-Hour .....	47.20	Type I or II F.R.* ..	151.00	Type III-1-Hour ....	71.40	Type V-N .....	44.20
Type II-N .....	44.10	Type III-1-Hour ....	125.00	Type III-N .....	68.20	<b>24. THEATERS:</b>	
Type III-1-Hour .....	51.30	Type V-1-Hour ....	119.20	Type V-1-Hour ....	66.90	Type I or II F.R. ....	101.60
Type III-N .....	48.10	<b>11. HOTELS AND MOTELS:</b>		Type V-N .....	63.00	Type II-1-Hour ....	74.00
Type V-1-Hour ....	34.70	Type I or II F.R.* ..	93.50	<b>17. PRIVATE GARAGES:</b>		Type III-N .....	70.40
<b>5. CHURCHES:</b>		Type III-1-Hour ....	80.90	Wood Frame.....	22.50	Type V-1-Hour ....	69.70
Type I or II F.R. ....	91.80	Type III-N .....	77.20	Masonry.....	25.40	Type V-N .....	65.90
Type II-1-Hour .....	48.90	Type V-1-Hour ....	70.40	Open Carports.....	15.30	<b>25. WAREHOUSES***:</b>	
Type II-N .....	65.50	Type V-N .....	69.00	<b>18. PUBLIC HEARINGS:</b>		Type I or II F.R. ....	45.70
Type III-1-Hour .....	74.90	<b>12. INDUSTRIAL PLANTS:</b>		Type I or II F.R.* ....	114.10	Type II or V-1-Hour .....	27.10
Type III-N .....	71.60	Type I or II F.R. ....	52.70	Type II-1-Hour ....	92.40	Type III or V-N .....	25.50
Type V-1-Hour ....	70.00	Type II-1-Hour ....	36.70	Type II-N .....	88.40	Type III or I-Hour .....	30.80
Type V-N .....	65.90	Type II-N .....	33.70	Type III-1-Hour ....	96.00	Type III-N .....	29.40
<b>6. CONVALESCENT HOSPITALS</b>		Type III-1-Hour ....	40.40	Type III-N .....	92.60	<b>EQUIPMENT:</b>	
Type I or II F.R.* .....	128.70	Type III-N .....	38.00	Type V-1-Hour ....	87.90	<b>AIR CONDITIONING:</b>	
Type II-1-Hour .....	89.30	Tilt-up .....	27.60	Type V-N .....	84.70	Commercial .....	3.80
Type III-1-Hour .....	91.60			<b>19. PUBLIC GARAGES:</b>		Residential .....	3.20
				Type I or II F.R.* ....	45.20	<b>SPRINKLER SYSTEMS</b>	
				Type I or II .....	34.00		2.40
				Open Parking*			
				Type II-N .....	26.50		
				Type III-1-Hour ....	34.30		
				Type III-N .....	30.50		
				Type V-1-Hour ....	31.20		

\*Add 0.5 percent to total cost for each story over three.

\*\*Deduct 20 percent for shell-only buildings.

\*\*\*Deduct 11 percent for mini-warehouses.

*Separate Valuation  
Rate Used For  
Residential Projects*

In 1989, the City Council enacted an ordinance that established a separate valuation rate for residential construction (single family, multi-family, and alterations). Specifically, the ordinance mandated the use of the average rate shown in the ICBO Table--Dwellings Type V—wood frame dwelling. As of

May 2000, this valuation rate equaled \$62.50 per square foot. The ordinance also prohibited the use of the regional modifier for determining residential valuation.<sup>1</sup> Further, the Building and Structure Permits Fee Schedule, effective July 1, 1998 to June 30, 1999, specifies a minimum valuation amount of \$14,350 for residential alterations.<sup>2</sup>

**The Building Division Assesses Building-Related Permit Fees**

The Division reviews building plans and issues building permits for a myriad of construction-related activities. These activities include items such as installing a water heater, building a new home or office building, or installing a new roof. The Division assesses fees for providing these services--reviewing building plans, issuing building permits, and inspecting building projects. The Division uses a City Council-approved Building and Structures Permits Fee Schedule. Exhibit 3 shows the City's current building permit fee table effective July 1, 2000 to June 30, 2001 that applies to residential and non-residential construction.<sup>3</sup>

**Exhibit 3    Building Permit Fee Table, 2000-01**

Total Valuation	Fee
Less than \$1,220	\$43
\$1,221 to \$2,000	\$43 for the first \$1,220 plus \$2.50 for each \$100 increment
\$2,001 to \$25,000	\$62.50 for the first \$2,000 plus \$10 for each \$1,000 increment
\$25,001 to \$50,000	\$292.50 for the first \$25,000 plus \$7 for each \$1,000 increment
\$50,001 to \$100,000	\$467.50 for the first \$50,000 plus \$5 for each \$1,000 increment
More than \$100,001	\$717.50 for the first \$100,000 plus \$2.50 for each \$1,000 increment

Source: Building Division.

Using the above table, a building valued at \$100,000 would cost \$717.50 in building permit fees, while a building valued at \$200,000 would cost \$967.50 (\$717.50 + \$250)

*The Building Division Issues Sub-Trade Permits*

In addition to the building permits, the Division also issues plumbing, mechanical, and electrical permits that are also known as sub-trade permits. According to Municipal Code

<sup>1</sup> The Division uses a regional modifier for calculating non-residential valuation.

<sup>2</sup> The current fee schedule, July 1, 2000 to June 30, 2001, specifies a minimum valuation amount of \$16,900 for residential alterations.

<sup>3</sup> The sample covered the period between January 1999 and June 1999. So we used the fee schedule covering that period which was June 1998 to July 1999.

24.01.100, sub-trade permits are issued for the administration and enforcement of the City of San Jose’s plumbing, mechanical, and electrical codes. Specifically, the Division uses the Code to administer, organize, and enforce the technical codes. These codes regulate the site preparation and construction, alteration, moving, demolition, repair, use, and occupancy of buildings, structures, and building service equipment within the City. The Division usually calculates sub-trade permit fees based upon square feet, however, sometimes they calculate the permit fees on a per inspection basis. The inspection fee is currently \$43 per trade. For sub-trades requiring more than one inspection, there is a \$75 minimum per trade inspection fee. The following table provides details about the plumbing, mechanical, and electrical permits the Division issues.

**Exhibit 4    Plumbing, Mechanical, Electrical Permit Fees For Residential And Non-Residential New Construction, Additions and Alterations**

Category	Sub-Trade Permit Fee Per Square Foot
New Single Family (excluding garages)	\$0.09
New Multi-Family (over 3 units)	\$0.10
Offices	\$0.06
Assembly Occupancies	\$0.10
Restaurant/Repair Garages Gas Stations/Hazardous Uses	\$0.22
Residential Additions, Retail, Research and Development, Manufacturing, and Medical and Dental Offices	\$0.15
Warehouses	\$0.04
Parking Structures/Shells	\$0.01
All Other	\$0.12
Permits requiring more than one inspection	Cost per sq. ft. applies. \$75 minimum.
Permits requiring one inspection only *	\$43 per trade per unit

Source: Building Division.

*The Building Division Issues Building Permits For Foundations And Building Shells*

The Division issues building permits to construct partial portions of buildings. These partial permits are issued for building foundations and exterior building shells. The Division issues these types of permits to accommodate the builders’ needs for an expedited building process. A foundation permit

allows a builder to start building the foundation before the Division has approved complete sets of building plans. Foundation permits are essentially issued in two parts. First, the Division issues foundation only permits for 10 percent of the total valuation. The Division subsequently issues a net of foundation permits for the remainder of the valuation (90 percent). In certain instances, the Division also issues partial permits, which are divided into three stages - the foundation permit is 10 percent of the valuation, and the net of foundation is sub-divided into 30 percent and 60 percent of the total valuation.

According to Division Staff, they also issue building shell permits for 90 percent of 80 percent of the total valuation. Shell permits allow a builder to obtain a building permit to construct the “shell” portion of a building without completing the building interior. The eventual tenant for such a building would be responsible for obtaining a building permit for the remaining 20 percent of the valuation to complete the building interior. A benefit of partial permits is that the builders’ initial cash outlay is reduced because they can obtain permits for only part of the project.

### *Plan Check Fees Charged*

The Division is responsible for charging plan check fees for reviewing building plans in compliance with applicable codes and regulations. The Division assesses plan check fees as a percentage of the building permit fees. The plan check fee is 72 percent of the building permit fee and an additional 12 percent when a State of California Title 24 energy review is performed.<sup>4</sup> The Division’s Automated Building Permit Information System (ABPIS) automatically charges the plan check fee once the permit technician enters the valuation amount and whether the structure is heated or unheated.<sup>5</sup> In addition, the Division is supposed to charge a supplemental plan check fee if the valuation increases after the initial plan check review. The ABPIS system is supposed to automatically charge the supplemental plan check fee due to a changed valuation after Division staff inputs a changed valuation.

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<sup>4</sup> There is also a fire plan check fee for multi-family, commercial, and industrial structures that is 56.7 percent of the building permit fee.

<sup>5</sup> ABPIS records the Title 24 Energy Review as a heated structure.

**Insufficient Documentation Prevents Verification Of Proper Valuation On Many Building Permit Applications**

Many of the building permit applications that we reviewed lacked sufficient documentation to verify that the Division properly valued the building or structure. Specifically, the building permit applications did not identify the valuation rate the Division used to establish the cost of construction for more than half of the building permit applications that we reviewed. As a result, Division officials frequently cannot confirm that staff used the correct valuation when calculating permit fees.

*The Division Staff Do Not Document That They Verified Self-Reported Valuations*

Based on our review of building permit applications, we found no evidence that Division staff verified self-reported valuation for commercial, industrial, multi-family, and single family construction. According to Division officials, Building Division staff are supposed to verify and confirm customer-reported valuation for all construction. As reported above, a building's or structure's valuation is critical to calculating building permit fees, plan check fees, and development taxes. A lower reported valuation amount results in lower permit fees. For example, a building valued at \$100,000 would cost \$717.50 in building permit fees, while a building valued at \$200,000 would pay \$967.50 or 35 percent more.

Further, Division staff use the building permit fee as the basis for calculating other fees such as plan check fees and fire plan check fees.

In our opinion, Division staff should be verifying self-reported valuations by reviewing contractor bids in the case of alterations. Division staff told us that it is not practical to accept bid documents for each and every permit application they receive. However, we saw no evidence that Division staff reviewed any contractor bids for commercial, industrial, multi-family, or single family alterations. Division staff also told us that they usually simply accept the self-reported valuations unless they seem to be unreasonably low.

We recommend that the Division:

**Recommendation #1**

**Require staff to document on the building permit application how they verified self-reported valuation.**

### *The Division Did Not Use Minimum Valuation Amounts For Forty Percent Of Sampled Residential Alteration Permits*

We found several instances where Division staff did not use the required minimum valuation amount for residential interior alterations. The Building Division's fee schedule prescribes a minimum valuation amount of \$14,350 for residential alterations, which translates to a minimum building permit fee of \$192.50. However, we found that the Division lacked procedures on how and when to apply the minimum valuation amount. As a result, the Division did not always apply the minimum valuation amount. Specifically, we found that about forty percent of the building permit applications of the total single family and multi-family alterations were below the minimum valuation.<sup>6</sup>

The following is a typical case where the Division should have charged the minimum fee but did not. On April 28, 1999, a builder submitted an application to obtain a building permit to remodel and build a bathroom in a single family home. The building permit application did not give information on the project's square footage or any customer-reported valuation. Nevertheless, the valuation amount the Division used to calculate the permit fee was \$10,000. This valuation is \$4,350 lower than the minimum amount of \$14,350. As a result, the Division undercharged the applicant, \$50 in building permit fees and \$42 in plan check fees.

In another instance a customer applied for a single-family alteration on April 19, 1999. The valuation amount was \$12,625, which is \$1,725 lower than the minimum amount of \$14,350. As a result, the Division undercharged the applicant \$20 in building permit fees and about \$16 in plan check fees.

According to the Chief Building Official, Building staff is not required to use the minimum valuation. Instead, Building staff have the discretion to use a valuation that is less than the minimum valuation if staff feels the lesser amount seems reasonable. Further, the only time Building staff actually use the minimum valuation is when they think the customer submits a low-ball valuation for his or her application.

It should be noted that on July 1, 2000, the Division promulgated a new policy on determining the valuation for remodeling and alteration projects (See Appendix B). This new policy establishes the following:

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<sup>6</sup> This excludes the single-family alterations in our sample with a valuation above \$100,000.



- Residential interior non-structural alteration: \$16,900 minimum or \$30.50 per square foot, whichever is greater, and
- Residential structural alteration: \$16,900 or \$50 per square foot, whichever is greater.

In our opinion, this new policy clearly establishes a minimum valuation for Residential Alterations of \$16,900. As such, Division Staff would not have the discretion to use a valuation that is less than \$16,900 for Residential Alterations.

It should be noted that on July 19, 2000, the Division promulgated another new policy titled *Policy of Valuation of Remodeling/Alteration Projects* (see Appendix C.) This new policy further expands upon the use of minimum valuations as follows:

Minimum valuations listed are applicable when **major alterations** are involved, **as defined by the Building Official**. When sq. ft. can not be determined or **minimum valuations are not applicable**, use of contract amount or estimated cost may be accepted. *[Emphasis added]*.

While this new policy allows for using a valuation that is less than \$16,900 for Residential Alterations, it still needs clarification. Specifically, the Division needs to define “major alterations” as used in the new policy. In addition, the Division needs to provide staff with formal guidance as to when “minimum valuations are not applicable.”

We recommend that the Division:

#### **Recommendation #2**

**Clarify its practice of using valuations that are less than the stipulated minimum for Residential Alterations.**

Because the Division did not use the minimum valuation for residential alterations, it undercharged certain building permit applicants. Specifically, we estimate that between January and June 1999, the Division undercharged applicants about \$3,100 in building permit fees, which equates to \$6,200 for the whole

year. This means that the Division also undercharged an estimated \$5,200<sup>7</sup> in plan check fees.

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**The Division Staff  
Did Not  
Consistently Apply  
Building Permit  
Fees**

Based on our review of building permit applications, we found that the Division 1) did not document how it calculated plan check fees; 2) did not always assess supplemental plan check fees; 3) inconsistently assessed sub-trade permit fees; 4) inconsistently issued partial permits such as foundation and building shell permits; and 5) did not retroactively assess applicable development taxes for shell only structures.

*The Division Did  
Not Document How  
It Calculated Plan  
Check Fees 14  
Percent Of the Time*

The Division typically assesses plan check fees as a percentage of the building permit fees. We found that the Building Division did not always assess and collect plan check fees as prescribed in the fee schedule. In our sample of 148 permit applications we found several instances where staff did not apply the plan check fees according to the fee schedule in 18 of the 148 (14%) permit applications we reviewed.

Some examples of the Division not documenting how it calculated plan check fees include the following cases.

On May 4, 1999, a customer applied for a building permit for a residential alteration. The customer paid a building permit fee of \$425 and a plan check fee of \$306. The latter fee was assessed at 72 percent of the building permit fee. This fee implies that a Title 24 energy review was not performed. We found no documentation noting that such a review was not required.

On April 2, 1999, the Division assessed a \$42.50 building permit fee for a \$20,000 single family residential alteration. At a minimum 72 percent building permit fee, the Division should have assessed a \$174 plan check fee. Instead, the Division assessed a \$42.50 plan check fee. The Supervising Plan Check Engineer said that sometimes the Division charges customers by inspection hours at \$85 per hour. However, there is no documentation as to how or why the Division charged \$42.50 instead of \$203. When this permit was initially processed, the Division had no written policy stating when it is appropriate or allowed to charge plan check fees based upon inspection hours instead of a percentage of the building permit fee. However, on July 1, 2000, the Division issued a new policy that covered its practice of assessing plan check fees.

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<sup>7</sup> 84 percent of the building permit fee.

On March 15, 1999, a customer applied for a building permit for a single-family alteration. The Division assessed a building permit fee of \$755. If there was an energy compliance review, the Division would have charged a plan check fee of \$634<sup>8</sup>. Instead, the Division charged only \$571-- a difference of \$63. It appears that the Division had charged an energy compliance fee for part of the structure and charged 72 percent for the remainder of the structure.

According to the Chief Building Official, documentation on whether an energy review was performed and how the plan check fee was calculated is stored away with the plans. In our opinion, Division staff can easily document how it calculated plan check fees on the comments section of the permit application (for example, Master File Review performed). This would allow Building Division management and the interested parties to review plan check fees for appropriateness without having to retrieve project plans from long term storage.

We recommend that the Division:

### **Recommendation #3**

**Require staff to document how it calculated plan check fees on the comments section of the permit application.**

#### *The Division Failed To Assess Supplemental Plan Check Fees In All Applicable Cases*

We found that the Division failed to assess supplemental plan check fees in all applicable situations. A valuation can change when the plan check engineer reviews the building plans and determines that the initial valuation is not correct. The Division is supposed to charge a supplemental plan check fee if the valuation increases after the initial plan check review. We found there was a change in valuation as a result of the plan check review for 10 percent of the permit applications in our sample. In all the cases in our sample, the building valuation amount increased to a higher amount.

We found that the Division system did not assess the supplemental plan check fees in 7 of the 11 (60 percent) cases in our sample when the supplemental plan check fee was applicable. Examples of the Division not calculating and therefore not assessing the supplemental plan check fees are shown below.

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<sup>8</sup> 84 percent of the building permit fee of \$755, which is \$634.

On April 30, 1999, a builder applied for a building permit to remodel and build an addition to a single family home. The project was initially valued at \$63,806 with an associated plan check fee of \$451. On June 21, 1999, when the building permit was issued, the valuation increased to \$123,806, which should have resulted in a supplemental plan check fee of \$201. According to a Division Official, the Division should have assessed and collected the \$201 supplemental plan check fee.

In another instance, a customer applied for a permit for an industrial “shell only” building. The valuation at that time was \$1.3 million with an associated plan check fee of \$3,100. When the customer came in for the building permit, the valuation increased to \$1.6 million. The Division should have assessed and collected a supplemental plan check fee of about \$700 but did not.

According to Division staff, the ABPIS system is supposed to automatically charge the supplemental plan check fee when there is a change in project valuation. According to Division Officials, when the staff enters the new valuation, a “glitch” in the APBIS system does not always result in the supplemental plan check fee being charged. This problem is exacerbated by the lack of supervisory review and/or a quality assurance process for the processing of permit applications. The Division is participating in the Integrated Development Tracking System (IDTS). According to Division Officials, the new IDTS system which should be in operation by the end of the year 2000, should address this “glitch.”

These computer system problems resulted in the Division not assessing and collecting applicable supplemental plan check fees. Based on transactions processed between January 1999 and June 1999, we estimate that the Division did not assess and collect about \$19,000 in supplemental plan check fees, which extrapolates to about \$38,000 for the entire year.

*The Division  
Inconsistently  
Calculated Or Did  
Not Document How  
It Calculated Sub-  
Trade Permits Seven  
Percent Of The Time*

In seven percent of the building permits we sampled, the Division did not always apply the fees in a consistent manner or Division staff did not document how they calculated the sub-trade permit fees. This resulted in Division staff treating customers with similar projects differently. The following example illustrates how Division staff applied sub-trade permit fees inconsistently for two similar projects.

On June 22, 1999, a builder applied for a building permit to build a 146 square foot addition and alteration to a single-

family residence. The Division should have assessed the minimum fee of \$43 per trade. Instead, the Division assessed the builder a sub-trade permit fee of \$97<sup>9</sup> per trade. According to the Supervising Plan Check Engineer, when an addition includes an alteration, the Division sometimes charges sub-trade fees based upon both the number of inspections and the square feet depending on the scope of the project.

However, in a similar single family addition and alteration of 1,314 square feet dated April 29, 1999, the Division calculated a sub-trade permit fee of \$197 per trade based only on a square foot basis. Thus, the Division calculated the sub-trade permit fees differently for two customers with similar projects. Had the Division calculated the sub-trade permit fees consistently the first customer would have paid \$43 per trade instead of \$197 per trade.

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**The Division  
Inconsistently  
Issued Partial  
Permits**

The Division issues partial permits that are for the construction of a part of a building or structure before the builder submits the entire set of plans and specifications. However, the Division does not have a formal policy or procedures on how to calculate partial permits. As a result, we found instances where the Division deviated from its normal practice when issuing partial permits.

For example, in a “net of foundation” permit application dated February 1, 1999, the valuation for fee purposes calculates to 30 percent of the total valuation. This is inconsistent with the Division’s current practice which is that the valuation for net of foundation is 90 percent of the total valuation. When we showed this permit application to the Permit Center Manager he agreed that this was an exception to normal Division practice and that he would have to look into the matter further. According to the Chief Building Official however, this was a common practice.

We found that Division officials and staff were not in agreement regarding the current Division practice of issuing partial permits. The Division typically issues “shell only” permits for projects with a construction value greater than \$1 million. According to the Division Official, the valuation for shell only permits should be calculated at 80 percent of the total

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<sup>9</sup> 146 sq. ft. X \$0.15 (sub-trade permit fee per sq. ft.) = \$21.90 + \$75 inspection fee = \$97

valuation. However, according to one of the Supervising Plan Check Engineers the Division should calculate shell only permit fees at 90 percent of 80 percent (72 percent) of the total valuation. In actual practice, however, the Division merely accepts the valuations customers report without applying any percentage. When we showed the Permit Center Supervisor one of the shell only applications we were reviewing, he could not explain how the Division determined the valuation and what, if any, percentage it applied. He also told us that until recently there was no verification of the valuation and that because of a lack of detailed documentation on the permit application, he could not explain how the Division calculated the valuation on most of the shell only permit applications.

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**The Division Did Not Retroactively Assess Applicable Development Taxes For Shell Only Structures**

Another area of concern for development taxes is the industrial versus commercial designation on shell only building permits. The problem arises when a developer designates a shell only building as industrial but the building's use is actually commercial. According to the Permit Center Manager, if the developer initially designates the building use as industrial they are exempt from paying certain development taxes. However, if the first tenant that actually uses the building subsequently designates the building's purpose as commercial on the building permit application for interior finish, the Division is supposed to collect any applicable development taxes from the tenant based upon the valuation of the interior finish. The Division does not, however, attempt to collect any applicable development taxes from the developer for the shell only portion of the valuation. According to the Permit Center Manager it is difficult to track a building from its original designation (industrial vs. commercial) to actual use. However the Division's own policy states that "*if the initial use is not a designated industrial use the commercial tax rate will be retroactively assessed on the construction valuation of the shell building at the time of the initial finish interior issuance.*" According to the Division Official, they do retroactively assess the development taxes but agreed that they cannot always collect the taxes for all shell only structures. The following example illustrates the industrial versus commercial designation problem for shell only buildings.

In a shell only permit application dated June 30, 1999, the developer designated the structure use as industrial. Because

the project was designated as industrial and it was located in the Edenvale exempt zone,<sup>10</sup> it was exempt from Business and Structure Tax and Commercial, Residential, Mobile Home Parks Tax. The valuation for the shell only structure was about \$224,000. The first tenant for this project subsequently applied for an interior finish permit to complete the interior of the same building. However, the tenant designated the structure as commercial. As a result, the Division charged the tenant all the applicable taxes. The Division did not, however, retroactively charge the developer any commercial rate for the shell only structure which was now applicable since the use of the structure was commercial not industrial. In this case, the Division should have retroactively charged the developer about \$7,800<sup>11</sup> in applicable development taxes.

The Division's failure to retroactively charge development taxes to developers when the initial use is not a designated industrial use can result in significant development tax losses. We identified five industrial<sup>12</sup> shell only permits the Division issued between January 1999 and June 1999 with a total valuation of \$2.9 million. We identified these shell only permits from the description in the scope of work portion of the data the Division provided to us. The developers designated all five structures as industrial and avoided \$102,000 in development taxes. If the initial use of these buildings was not industrial, the Division should have retroactively charged developers \$102,000 in development taxes. This would extrapolate to over \$200,000 in unassessed development taxes over the course of a full year if the same pattern held constant.

In our opinion, the potential exists for developers to take advantage of the Division's failure to retroactively assess development taxes. Specifically, a sophisticated developer would always designate a building as industrial when applying for a shell only building permit. By so doing, the developer would avoid paying development taxes regardless of the actual use of the building. In our opinion, the Division needs to

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<sup>10</sup> Industrial use structures are exempt from paying Construction Tax and Business and Structure Tax in the Edenvale exempt zone but commercial structures are not.

<sup>11</sup> CRMP Tax of \$6,716.39 + (\$3,358.19 (B&S for Commercial) - \$2,238.80 (B&S for Industrial)). Also, refer to Exhibit 5.

<sup>12</sup> The five shell only permits were from a total of about 200 industrial permits with a total valuation of about \$ 128,300,000.

remedy this situation by implementing a process to retroactively charge developers with development taxes when the designation of the building changes from industrial to commercial.

We recommend that the Division:

**Recommendation #4**

**Ensure that Division staff retroactively assess commercial rates if the initial use is not a designated industrial use.**

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**Lack Of Policies  
And Procedures**

The Building Division lacked formal policies and a comprehensive procedures manual. Formal policies communicate management's or other authorizing body's intentions and expectations. Procedures are written instructions on how employees are to carry out activities in an effective, efficient, and economical manner and in conformity with prescribed policies. The Division had no formal policies and/or procedures to guide staff regarding:

- Verifying valuations for commercial and industrial new construction;
- Establishing the valuation for residential, commercial, and industrial alterations;
- Calculating plan check fees;
- Collecting supplemental plan check fees when valuation changes;
- Calculating sub-trade permits; and
- Calculating partial permits.

According to Division staff, prior to the commencement of the audit the Division had no formal policies and procedures to clarify the above-mentioned issues. As a result of our audit, the Division issued new policies on July 1, 2000 to clarify certain issues that we raised during the audit. We found that the Division's new policies clarify the following issues.

- How sub-trade permits should be assessed for new construction, additions, major and minor alterations;
- Assessing the valuation for residential, commercial and industrial new construction and additions;



- Calculating plan check fees for structures where the square footage is given and sub-trade plan checks where the scope of the work is not represented by the square footage;
- Collecting supplemental plan check fees when the valuation has changed; and
- Calculating partial permits.

In our opinion, the Division should provide training to its staff on its new policies and also clarify when building plan check fees can be calculated either on a square footage basis or a per inspection basis.

We recommend that the Division:

**Recommendation #5**

**Provide training to its staff on its new policies and also clarify when building plan check fees can be calculated either on a square footage basis or a per inspection basis.**

**The Building Division Does Not Have A Formal Quality Assurance Process**

The Division does not have a formal quality assurance process. For example, Division Supervisors do not review permit applications before Division staff issue permits. Instead, an Account Clerk performs a limited review of permits for errors prior to permit issuance. According to the Permit Center Supervisor, if the Account Clerk detects any errors, she directs them to him and he keeps a regular log of the detected mistakes and the resultant corrective action in a database. This method can be problematic when the Account Clerk is unavailable to check permits because she is on a lunch break, vacation, sick leave, or away from the office. In our opinion, the Division should develop a formal quality assurance process for the assessment and collection of building-related permit fees.

We recommend that the Division:

**Recommendation #6**

**Develop a formal quality assurance process for the assessment and collection of all building-related permit fees**

<b>The Building Division May Have Failed To Assess \$49,400 In Building Related Fees</b>	Based on our review of sampled cases, we project that for a 12-month period, the Division undercharged applicants up to \$49,400 in building related fees. Specifically, this would include up to \$38,000 in supplemental plan check fees and \$11,400 in building permit and plan check fees from not applying the minimum valuation rate.
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<b>CONCLUSION</b>	The Building Division lacks assurance that it calculates permit fees and development taxes on a consistent basis and treats customers on a consistent and equitable basis. Because of a lack of formal policies and procedures, individual staff may interpret ordinances and fee schedules differently. The Division undercharged applicants an estimated \$49,400 in permit fees and plan check fees. In our opinion, the Division needs to develop and implement formal policies, procedures, and a quality assurance process to ensure that 1) the valuations for all properties are verified; 2) minimum valuation is used for residential alterations; 3) plan check fees are calculated correctly and documented; 4) supplemental plan check fees are collected; 5) sub-trade permits are accurately calculated; 6) partial permits are consistently issued; and 7) development taxes are retroactively assessed for shell only structures. As a result, the Division will be better able to ensure that Division staff apply building permit fees and charges consistently and correctly.
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**RECOMMENDATIONS**

We recommend that the Building Division:

<b>Recommendation #1</b>	<b>Require staff to document on the building permit application how they verified self-reported valuation. (Priority 2)</b>
<b>Recommendation #2</b>	<b>Clarify its practice of using valuations that are less than the stipulated minimum for Residential Alterations. (Priority 2)</b>
<b>Recommendation #3</b>	<b>Require staff to document how it calculated plan check fees on the comments section of the permit application. (Priority 2)</b>

- Recommendation #4**      **Ensure that Division staff retroactively assess commercial rates if the initial use is not a designated industrial use. (Priority 2)**
- Recommendation #5**      **Provide training to its staff on its new policies and also clarify when building plan check fees can be calculated either on a square footage basis or a per inspection basis. (Priority 2)**
- Recommendation #6**      **Develop a formal quality assurance process for the assessment and collection of all building-related permit fees (Priority 2)**

Finding II

Improvements Are Needed To Ensure That The Building Division Assesses And Collects Development Taxes Consistently And In Compliance With Municipal Code Requirements

The Municipal Code prescribes how various development taxes are to be calculated and assessed. We found several problems with the Building Division’s (Division) assessing and collecting of these taxes. Specifically, we found that the Division

- Charged applicants for development taxes even though the permitted properties were exempt from taxes;
- Misidentified exempt zones; and
- Misapplied Commercial, Residential, And Mobile Home Park (CRMP) Construction Taxes.

We also found that improvements are needed to ensure buildings are classified in compliance with Municipal Code requirements. We found that Division staff determined building use based on limited and unverified information. Finally, we determined that staff were not in agreement on how to classify certain types of structures or structures that were designed for multiple uses.

As a result, the Division improperly assesses and collects some of the development taxes and processes a large number of refunds. In our opinion, the Division should develop a formal policy and guidelines for calculating CRMP Taxes on residential structures and ensure that exempt zones are clearly identified on permit applications. In addition, the Division should implement additional controls to guide staff in properly designating building use for fee assessment purposes.

The Building Division Collects Municipal Code-Specified Taxes

The Division collects a number of development taxes on construction to support the City’s capital programs. The Division calculates the taxes either 1) as a percentage of the project valuation, 2) as a function of the square feet, or 3) on a per unit basis. The main development taxes the City collects as part of the building process are:

- Commercial, Residential, and Mobile Home Park (CRMP) Construction Tax;

- Building and Structure (B&S) Construction Tax;
- Residential Construction Tax; and
- Construction Tax.

The Municipal Code sets the tax rates and how the funds collected from the taxes should be applied. The following table summarizes the development tax rates:

### Exhibit 5 Summary Of Development Tax Rates

<b>Tax</b>	<b>Rate</b>	<b>How Utilized</b>
Commercial, Residential, Mobile Home Park Construction Tax (CRMP)	<b>Commercial</b> – 3 percent of total building valuation <b>Industrial</b> – NA. <b>Residential</b> – 2.75 percent of 88 percent of building valuation	Unrestricted use but historically used for traffic improvements.
Building and Structure Construction Tax (B&S)	<b>Commercial</b> – 1.5 percent of building valuation <b>Industrial</b> – 1 percent of building valuation <b>Residential</b> – 1.75 percent of 88 percent of building valuation	For the acquisition of land and interests in land and the construction and repair of existing and proposed city streets (not maintenance and repair).
Residential Construction Tax	<b>Residential</b> 1 Family – \$180/unit 2 Family – \$136.80/unit 3&4 Family – \$122.10/unit 5-19 Family – \$99/unit 20 Family &up – \$90/unit	Reimburse developers who have at their expense constructed or developed major streets, highways and expressways.
Construction Tax	<b>Commercial, Industrial, and all other non-residential uses</b> – \$.08/sq ft of all new building <b>Residential</b> 1 Family – \$150/unit 2 Family – \$114/unit 3&4 Family – \$101.75/unit 5-19 Family – \$82.50/unit 20 Family &up – \$75/unit	For construction and development of parks, library, fire protection services, recreation areas, communication facilities, other public works maintenance facilities, and other general municipal improvements.

Source: Municipal Code.

**The City Offers  
Builders  
Exemptions From  
Development Taxes  
Based On Building  
Location And  
Structure Use**

The City established the Central Incentive Zone in 1981 and began suspending the collection of construction-related taxes to support redevelopment efforts for commercial, industrial, and residential development in the Downtown area. The City established the Enterprise Zone Target Areas in 1986, and created the Edenvale Incentive Zone<sup>13</sup> in 1990 to encourage industrial development in the City’s southern industrial redevelopment area and to provide a better balance between jobs in the north and housing in the southern part of the City. The following table summarizes the tax exemption zones, taxes suspended, eligible development, and duration.

**Exhibit 6      Summary Of The Tax Exemption Zones, Taxes  
Suspended, Eligible Development, And Duration**

Zone	Taxes Suspended	Eligible Development	Duration
Central Incentive Zone	B&S, Construction Tax, CRMP and Residential Construction Tax	Residential	Sunsets 12/31/2001
Enterprise Zone Target Areas	B&S, Construction Tax, CRMP and Residential Construction Tax	Residential, Commercial, and Industrial	Sunsets 12/31/2001
Edenvale Incentive Zone	B&S and Construction Tax	Commercial and Industrial	Sunseted 1/1/2000

Source: Auditor Analysis of the Office of Economic Development’s Analysis Of Costs And Benefits Associated With Tax Incentives In The Edenvale Incentive Zone, Central Incentive Zone, And Target Areas Of The Enterprise Zone.

*The Building  
Division Uses  
MapInfo To  
Determine Exempt  
Areas*

The Division uses a computer program called MapInfo to determine whether a particular project is in any of the exempt zones. Division staff first looks up the Assessor’s Parcel Number (APN) on a database with County information called Experian. Staff uses the APN to pinpoint the exact location of the address on MapInfo to determine if the area is in an exempt

<sup>13</sup> This exemption sunseted in December 1999 and is no longer in force since January 1, 2000.

zone. When it is not possible to get an APN, Division staff either look at a physical map or the permit history.

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**The Municipal Code Defines Industrial And Commercial Uses**

The Municipal Code provides direction on categorizing a building (structure) as industrial or commercial use for assessing development taxes. The Code references the Zoning Ordinance (Title 20) which defines industrial structures based on allowable uses in certain zones and Districts in the City. These zones are classified by order of restrictiveness from the most restrictive zone (open space) to the least restrictive (manufacturing). Code Section 4.46.050B defines industrial uses as permitted under the Laboratory and Research District or less restrictive districts—the Industrial Park District (IP-a, b, c, d) and Manufacturing District (M-1 and M-4). These are known as the primary uses. Title 20 specifies that laboratories devoted exclusively to research, product development and testing, engineering development, and sales development are considered industrial uses.

Developers of industrial use buildings are exempt from paying the CRMP Taxes and pay a lower rate for the B&S Taxes. For example, a developer constructing an industrial structure valued at \$1 million would receive tax savings of \$35,000. Specifically, the developer would pay \$10,000 in B & S Taxes as opposed to \$45,000 in CRMP Taxes and B & S Taxes if the building had a commercial designation.<sup>14</sup>

*Professional And Business Offices Can Be Classified As Industrial Use In Certain Situations*

The Municipal Code also allows professional and business offices to be classified as industrial use if certain criteria are met. Specifically, Title 20 allows the operator of the primary industrial use to build separate offices for professional or business use if they are 1) incidental and necessary to the conduct of the primary use and 2) are conducted within the same lot as the primary use. The Code identifies professional or business use as a secondary use, which includes executive, engineering, accounting, scientific, research and development, educational, statistical, and financial offices. Under the “within the same lot” concept, if an industrial business had an administrative office located in another part of the City that was not contiguous with the primary site, then that administrative office should be classified as commercial as opposed to industrial.

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<sup>14</sup> See page 26 of report for summary of development tax rates.

*Multiple Use Structures Should Be Classified At The Highest Rate*

The Municipal Code provides guidance on categorizing buildings with multiple uses. With regards to the B&S Taxes and the CRMP Taxes, the Code specifies, “if the building or structure or portion thereof is designed or intended to be used for more than one purpose, [including industrial purposes...], the purpose for which the rate is highest shall control and such highest rate shall apply.” In other words, buildings with multiple uses should be classified at the highest rate. This means that a building with both commercial and industrial uses within the same building should be designated as commercial.

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**The Division Uses A Matrix To Define Industrial/ Commercial Uses**

We found that Division staff utilized a recently developed matrix to help them distinguish between commercial and industrial uses. With the assistance of the Planning Division and the Office of Economic Development, the Division implemented this matrix on September 17, 1999. The development tax matrix outlines 94 possible building uses that can be classified as industrial use. The matrix is applicable citywide. According to the Permit Center Manager, this matrix has made it much easier for Division staff to designate structures as industrial or commercial since all staff need to do is review the matrix and see whether the proposed use applies to the structure.

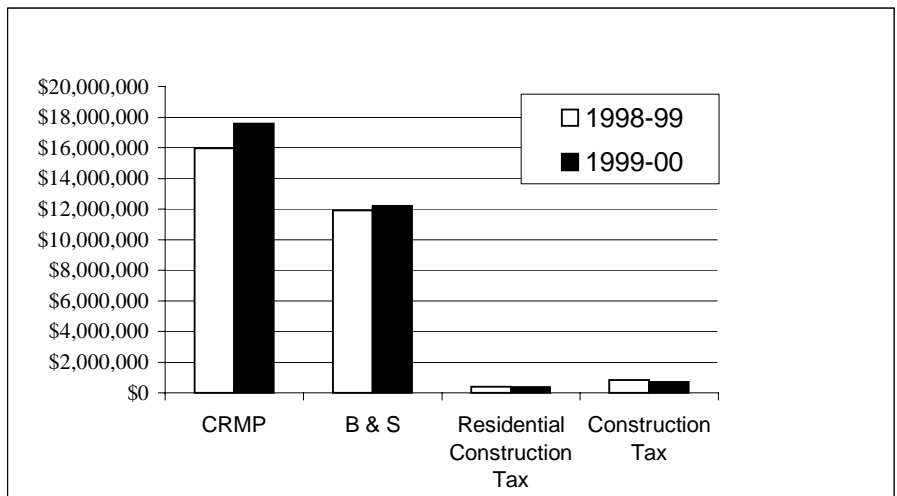
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**Fee Revenue Collected**

In 1999-00, the Division collected \$30.9 million in development tax revenue from Building-related applicants. Specifically, in 1999-00, as shown in Exhibit 7, these included about \$12.2 million from the B&S Tax, \$17.6 million from the CRMP Tax, \$361,000 from the Residential Construction Tax, and \$709,000 from the Construction Tax.



## Exhibit 7 Development Tax Revenue Collected In 1998-99 And 1999-00



Source: Budget Office.

### The Division Charged Applicants For Development Taxes Even Though The Permitted Properties Were Exempt From Taxes

We found some instances where Division staff charged customers for development taxes even though the project was identified as being in an exempt zone. Division staff enter information about whether a project is in an exempt area in designated boxes on the building permit application. This information should be sufficient to indicate to the permit technician whether the structure is exempt from development taxes. We found some instances when this information was listed on the permit application but the permit technician still charged the taxes to the applicant.

For example, a permit application dated January 4, 1999, identified the project as being in the enterprise zone and exempt from CRMP, B&S, and Construction Taxes. However, the Division incorrectly assessed and collected \$13,000 in taxes from the applicant. Because the application was made over a year ago, the Municipal Code does not allow for a refund to be paid to the applicant.

We recommend that the Division:

#### Recommendation #7

**Modify the permit application to more clearly identify exempt zone designations.**

**Staff Sometimes Have To Rely On Maps To Determine A Property's Location**

Division staff use a program called MapInfo to identify whether a project is in an exempt zone based on the location. To determine the exact location of the property on MapInfo, Division staff need an APN. The APN is found on a database with County information called Experian. However, sometimes the APN is not available on this database, either because the location in question is on a new street or because of the time lag that occurs for the County to update its database. According to the Permit Center Manager, this could take up to one year. In such instances, Division staff have to resort to looking at actual maps to determine whether the property in question is in an exempt area.

We examined 12 permit applications from our sample to measure Division staff's accuracy in determining the exempt zones. We found that Division staff had misidentified the properties 30 percent of the time. The Chief Building Official indicated that dedicating a staff member to review these permit applications would alleviate the problem.

We recommend that the Division:

**Recommendation #8**

**Designate technically qualified staff members for those permit applications that require looking at actual maps to determine if a property is in an exempt location.**

**The Division Misapplied Commercial, Residential, And Mobile Home Parks Tax (CRMP)**

We found that Division staff did not consistently apply the exemption for the CRMP Tax. Residential alterations that do not increase the living area by more than 50 percent are exempt from the CRMP Tax. For example, a residential alteration with an addition of 500 square feet or less to an already existing 1,000 square feet would be exempt from the CRMP Tax.

We found some cases where the Division collected the CRMP Tax even though the project did not increase the living area by more than 50 percent. For example, a homeowner applied for a building permit on February 10, 1999, for a residential alteration and addition of 1,135<sup>15</sup> square feet, to an existing

<sup>15</sup> 740 sq. ft and 395 sq. ft. of garage.

living area of 2,583<sup>16</sup> square feet, a 44 percent increase in living area. The Division assessed and collected a CRMP Tax of \$1,300. In this case, the Account Clerk spotted the error and the Division refunded the tax to the applicant.

Some of the residential alteration refunds we reviewed were caused because staff did not include attached garages in the total living area while calculating the CRMP tax. According to Division staff, attached garages are included and detached garages are excluded while calculating the total living area. However we found some instances where Division staff had incorrectly applied the current Division practice of including attached garages.

For example, a homeowner applied for a building permit on September 1, 1999 for a residential alteration and addition of 753 square feet to an existing area of 1,340 square feet with an attached garage of 541 square feet. This meant that there was a total of about 1,880 square feet of living area. There was an increase in living area of about 40 percent. However the Division assessed and collected a CRMP tax of \$1,540. In this case, the Account Clerk spotted the error and the Division refunded the tax to the applicant.

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**The Building Division Has No Formal Policies And Procedures On Assessing The CRMP Tax**

We found that the Division has no formal policies and written procedures on CRMP for residential alterations. In addition, staff are confused as to how to determine what constitutes living area for purposes of assessing the CRMP tax.

We recommend that the Division:

**Recommendation #9**

**Develop a formal policy, procedures, clear guidelines, and staff training on calculating CRMP Taxes on residential structures.**

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<sup>16</sup> 2084 sq. ft and 499 sq. ft. of garage.

**Improvements Are Needed To Ensure Buildings Are Classified In Compliance With Municipal Code Requirements**

We found that the Division needs to improve its controls to ensure staff categorize buildings in compliance with municipal code requirements. Based on our review of building permit applications, we identified multiple instances where Division staff failed to classify buildings in accordance with industrial and commercial code requirements. Further, we found that the Division staff determined building use based on limited and unverified information. In addition, we found that Division staff were not in agreement on how to classify certain types of structures that are not listed on the matrix or were designed for multiple uses.

We found that in certain situations Division staff did not designate buildings or structures as industrial uses on a consistent basis. For example, we identified a building project on Zanker Road where a single owner received eight different building-related permits over a 28-month period. As shown in Exhibit 8, Division staff designated the structure as industrial for five permit applications and designated the same structure as commercial for three permit applications. In our opinion, because staff did not classify this structure in the same manner for all eight permit applications, this evidences Division staff’s confusion regarding industrial vs. commercial designations.

**Exhibit 8     Project With Multiple Commercial And Industrial Designations**

Date of Permit Application	Industrial Versus Commercial Designation	Scope of Work On Permit Application
7/28/97	Industrial	Shell Only
1/12/98	Industrial	Installation of storage racks
12/07/98	<b>Commercial</b>	Alteration/Repair
1/04/99	<b>Commercial</b>	Parking lot, plumbing permit
2/16/99	Industrial	Alteration/Repair
3/22/99	Industrial	Mechanical permit
4/07/99	<b>Commercial</b>	Alteration/Repair
11/24/99	Industrial	Mechanical Permit

Source: Auditor analysis of Building Division data.

We found that the Division staff determined building use based on unverified information permit applicants provided. For example, on July 1,1999, Division staff designated a building as commercial based on the proposed building use listed on the

application--*office-commercial*. The Division collected \$45,000 in development taxes from the applicant. However, on August 6, 1999, the same applicant informed the Division that the intended use of the building was mainly research and development. Consequently, the Division changed the building use designation to industrial and refunded the applicant \$35,000.

On further review of this permit application, we found that the company's manufacturing facility was located in another state and that the San Jose site was mainly a support office. When we reviewed the permit application with the Chief Building Official he agreed that this was one of those situations the Division faces where the building use is not clear. He further stated that in these situations the Division almost always goes by the information the applicant provides. However, he also told us that in this particular situation, the Office of Economic Development (OED) made the final decision to designate the structure as industrial. According to an OED representative, they designated this structure as industrial because the applicant stated that the structure would be used for product development, in which case the industrial designation would be correct.

Relying on the applicant's stated use for the structure in this particular case is problematic given that the permit applicant changed its proposed structure use. Specifically, in the initial permit application the applicant designated the building use as commercial/office space with light research and development. At a later date, the applicant informed the Division that the intended use of the building was mainly research and development. In our opinion, the Division needs to ensure that developers do not take advantage of the significant tax advantage that designating a structure as industrial creates, and that the Division treats all customers consistently.

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**The Division Needs To Ensure That Staff Are In Agreement On How To Classify Multiple Use Structures**

We found that the Division needs to ensure that staff properly classifies multiple use structures. Specifically, we found that staff was not in agreement on how to classify structures designed to be used for more than one purpose. We found that all levels of staff had a different understanding on how to classify multiple use structures. The Chief Building Official told us that multiple use structures are classified based on the use that is more than 25 percent of the building use. However, the Municipal Code does not provide for classifying multiple

use buildings according to a set percentage. Contrary to the Chief Building Official’s position, the Chief Plan Check Engineer and a Plan Check Supervisor told us that staff classify multiple use buildings based upon business type or the zone where the business is located. Further, a Plan Check Supervisor said that he usually goes with the use that is more than 50 percent of the structure when the floor plan is clear. Another Supervisor told us he was not sure how to classify these structures.

As we noted earlier, the Municipal Code provides that buildings with multiple uses should be classified at the highest rate. However, Division staff told us that this multiple use issue is a “gray area”. As a result staff is unsure if a multiple use refers to one business with several uses or multiple types of businesses within the same building. The difficulty in such mixed uses also arises in designating which use is the primary use and which use is the supporting use. Because of an absence of adequate Division guidance, staff is not in agreement and confused as to industrial vs. commercial designations for multiple use structures.

<b>Several Factors Hamper The Ability Of The Division Staff To Ensure That Structures Are Properly Designated</b>	<p>We found that the Division staff had difficulty classifying structures consistently based on the Municipal Code requirements. We identified several contributing factors that prevented Division staff from properly designating the most appropriate building use. These factors included the following: 1) building permit applications do not provide detailed information on proposed building use; 2) in some situations, the Division may need to follow up on the actual use of the building; 3) the Division’s development tax matrix needs to be improved; and 4) the Division has not assigned responsibility for determining building use in unclear situations.</p>
<b>Building Permit Applications Do Not Provide Detailed Information To Make Informed Decisions</b>	<p>We found that Division staff typically designated a building as commercial or industrial based on the applicant provided information. Division staff, not the applicant, recorded the intended use of the structure on the permit application by marking a box as either industrial or commercial.</p> <p>In some situations when the intended use was not clear or readily apparent, Division staff asked applicants to provide additional information on the proposed building use. In other situations, the permit applicant was the contractor, who may not</p>

know the intended use of the structure. Building permit applicants are only required to date and sign building permit application forms. Specifically, the applicant signs the following statement:

“I certify that I have read this application and state that the above information is correct . . .”

In our opinion, the current form and process provides the Division with insufficient information on proposed building uses. A more effective tool for determining building use would be a separate form that the applicant would complete that itemizes specific building uses such as manufacturing, research and development, and administrative office space. Further, such a form should include a more declarative statement for the applicant to sign that clearly conveys that the applicant may be subject to penalties for providing false information on his or her permit application. For example, the City’s registration form for Business Tax requires applicants to sign the following statement:

“I declare, under penalty of perjury, that the information contained in this application is true and correct . . .”

Such a form would provide Division staff with detailed information on building use that inspectors could use to subsequently verify actual use of the structure when performing inspections. In addition, requiring applicants to declare under penalty of perjury that the information they are providing regarding the building’s use is correct would communicate the importance to the applicant of the information they are providing and the serious consequences that could result from providing false information.

We recommend that the Division:

#### **Recommendation #10**

**Develop a form that 1) itemizes specific building uses such as manufacturing, research and development, and administrative office space and 2) includes a statement for applicants to sign regarding penalties for providing false information on the permit application form.**

**Additional Follow-Up Efforts Can Ensure Building Use Is Accurate**

We found that the Division needs to follow-up on building use when an applicant claims an industrial designation for tax purposes. The potential exists that an unscrupulous developer could falsify an industrial use, in order to take advantage of the industrial use tax exemption. In our opinion, Division staff should develop a follow-up process to verify that the applicants actually use buildings for the stated purpose when an industrial designation is involved.

We recommend that the Division:

**Recommendation #11**

**Develop a follow-up process to verify that applicants actually use buildings for the stated purpose when an industrial designation is involved.**

**Development Tax Matrix Used To Define Industrial Structures Needs To Be Improved**

We reviewed the development matrix the Division staff uses to categorize building use and found that the matrix agreed with the Code. However, we found that the Division needs to improve the matrix to ensure that all possible industrial uses are identified. Specifically, we found that the matrix does not define what uses constitute research and development, or provide guidelines on classifying multiple use structures. In our opinion, the Division needs to work with the City Administration and the City Attorney’s Office to develop better guidelines for these gray areas.

We recommend that the Division:

**Recommendation #12**

**Work with the City Attorney’s Office and Administration to develop guidelines for what constitutes research and development and classifying multiple use structures.**

**Responsibility Not Assigned For Determining Building Use In Unclear Situations**

The Division has not assigned responsibility for deciding if structures are industrial or commercial when the proposed use is not clear. According to a permit technician, it is the plan check engineers who make the decision on building use. However, according to a plan check engineer, they only verify the information regarding building use that a permit technician marks on the application. It is also unclear as to who is responsible for making industrial versus commercial use designations. According to the Chief Building Official, the



Division defers to the OED when deciding if a structure is industrial or commercial. However according to the OED, they have a very limited role in this process and intervene only when there is a confusing issue. In our opinion neither the plan check engineers nor the permit technicians are equipped or qualified to make decisions regarding the use of the building. This is more of an administrative responsibility and involves interpreting the Code. The Division should designate an authoritative organization or person to render industrial versus commercial designation decisions to help ensure that the Division interprets the Code accurately and treats its customers consistently.

We recommend that the Division:

**Recommendation #13**

**Designate an authoritative organization or person to render industrial versus commercial structure designation decisions where the structure use is unclear or complex.**

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**Inaccurate  
Structure  
Designations Can  
Lead To Significant  
Underpayment Of  
Taxes**

It is in the City's financial best interest to ensure that it appropriately classifies buildings as either industrial or commercial. Buildings that the Division incorrectly classifies as industrial result in a loss of revenue to the City. Conversely, when the Division incorrectly classifies a building as commercial it results in applicants paying too much.

Between January 1999 and June 1999, the Division classified about 200 structures as industrial with a total valuation of about \$128.3 million. Since these projects were classified as industrial, permit applicants did not pay about \$3.8 million in CRMP Taxes. Further, because of the industrial classification, these applicants paid \$641,500 less in B&S Taxes.

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**CONCLUSION**

The Division improperly assesses and collects some of the development taxes, overcharges or undercharges applicants, and processes a large number of refunds. Lack of guidance on industrial use definitions leads to Division staff making subjective interpretations. In our opinion, the Division should develop a formal policy and guidelines for calculating the CRMP Tax on residential structures. Further, the Division should ensure that exempt zones are clearly identified on permit applications, develop guidelines and provide staff with training on exemptions to development taxes, implement controls to

guide staff on properly designating the most appropriate building use.

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## RECOMMENDATIONS

We recommend that the Division:

- Recommendation #7**     **Modify the permit application to more clearly identify exempt zone designations. (Priority 2)**
- Recommendation #8**     **Designate technically qualified staff members for those permit applications that require looking at actual maps to determine if a property is in an exempt location. (Priority 3)**
- Recommendation #9**     **Develop a formal policy, procedures, clear guidelines, and staff training on calculating CRMP Taxes on residential structures. (Priority 2)**
- Recommendation #10**     **Develop a form that 1) itemizes specific building uses such as manufacturing, research and development, and administrative office space and 2) includes a statement for applicants to sign regarding penalties for providing false information on the permit application form. (Priority 2)**
- Recommendation #11**     **Develop a follow-up process to verify that applicants actually use buildings for the stated purpose when an industrial designation is involved. (Priority 2)**
- Recommendation #12**     **Work with the City Attorney's Office and Administration to develop guidelines for what constitutes research and development and classifying multiple use structures. (Priority 2)**
- Recommendation #13**     **Designate an authoritative organization or person to render industrial versus commercial structure designation decisions where the structure use is unclear or complex. (Priority 2)**